Yen 4Sight

Highlights

- The Government downgraded its assessment of the economy due to weak March data prompting calls for policy action.
- Economic surveys such as the Economy Watchers point to a soft start to Q2 while producer prices point to limited pressure in the CPI inflation pipeline.
- The coming week brings data for GDP in Q1, goods trade and inflation in April, and machine orders in March.

Chris Scicluna
+44 20 7597 8326
Chris.Scicluna@uk.daiwacm.com

Interest and exchange rate forecasts

End period	17 May	Q219	Q319	Q418
BoJ ONR %	-0.10	-0.10	-0.10	-0.10
10Y JGB %	-0.07	-0.07	-0.07	-0.10
JPY/USD	110	110	107	105
JPY/EUR	123	126	121	118

Source: Bloomberg, BoJ and Daiwa Capital Markets Europe Ltd.

Soft dataflow persists ahead of Q1 GDP report

Ahead of the first estimate of Q1 GDP on 20 May, the past week brought further data to provide insight into momentum in Japan's economy at the end of the first quarter and start of Q2. And, after the previous week's shockingly weak wage figures, these extended a newsflow that has been largely downbeat of late. Indeed, the week kicked off with the Cabinet Office's preliminary March composite business conditions indicators – calculated from 29 data series related to production, jobs, spending and financial conditions – which were considered by the Government to be so downbeat as to justify a negative revision to its assessment of the state of the economy.

Government assessment weakest since 2012-3…

In particular, the Cabinet Office's composite coincident indicator of economic conditions fell 0.9pt in March to 99.6, the lowest level since September 2016. And the leading indicator fell 0.8pt to 96.3, the weakest in almost three years. So, having at the start of 2019 identified "a possible turning point", the Cabinet Office downgraded its economic assessment to "worsening" for the first time since the euro crisis more than six years ago. Prior to that, such an adverse judgement had been made only throughout the Global Financial Crisis, shortly after the system of assessments was introduced in early 2008.

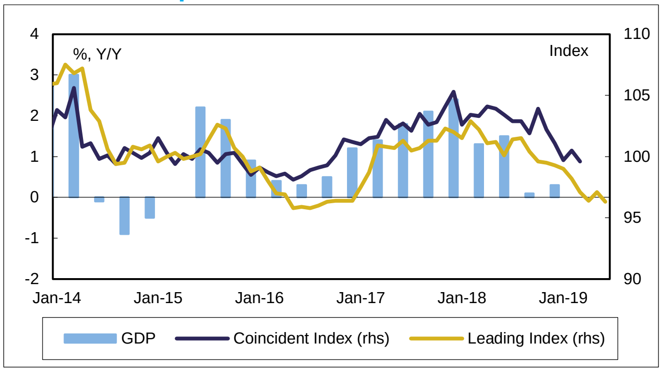
…prompting calls for further stimulus

The Cabinet Office's downbeat assessment prompted calls for policy action from various quarters. At a regular session in the Diet, however, Governor Kuroda predictably stated that he was not considering adding monetary stimulus, although the Policy Board would be ready to do so if the outlook merited it. But noting ongoing weakness in exports, PM Abe stated that the Government would prioritise support for domestic demand. While that could imply plans for little more than another token supplementary budget, it renewed speculation that he was mulling postponement of the consumption tax hike, to 10%, currently legislated for October.

Will or won't Abe hike the consumption tax?

The Government has already planned several measures – such as a reduced tax rate for certain goods, an increase in welfare benefits for pensioners, and the provision of free education – to support demand after the tax hike. As such, the BoJ estimates that the net burden of the tax hike on households would be a mere ¥2trn, a quarter of the hit from the

GDP and composite business conditions indices*



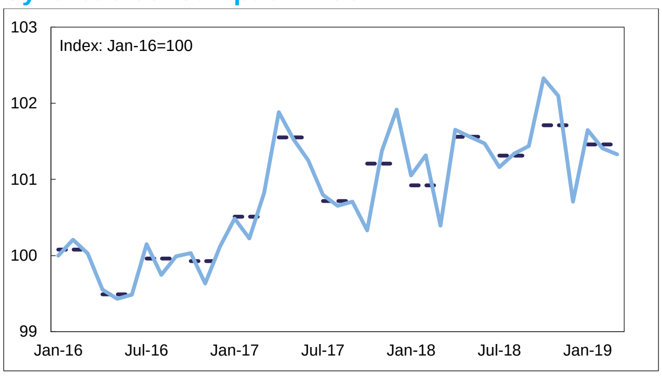
Leading index has 3-month lead. Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Cabinet Office assessments of Coincident Index

Dates	Cabinet Office assessment
Sep-2012	Signalling a possible turning point
Oct 2012-Jan 2013	Worsening
Feb-Apr 2013	Halting to fall
May-Jun 2013	Signalling a possible turning point
Jul 2013-Mar 2014	Improving
Apr-Jul 2014	Weakening
Aug-Nov 2014	Signalling a possible turning point
Dec 2014-Apr 2015	Improving
May 2015-Sep 2016	Weakening
Oct 2016-Aug 2018	Improving
Sep-Dec 2018	Weakening
Jan-Feb 2019	Signalling a possible turning point
Mar-2019	Worsening

Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Synthetic consumption index*



**Dashed line shows quarterly average. Source: Cabinet Office, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

last consumption tax hike in 2014. And with Abe previously stating that it would take an adverse shock of Lehman proportions to lead him to postpone the hike this time around, our central expectation remains that it will go ahead. But Abe might well wait for the findings of the BoJ's Tankan survey in early July before deciding definitively one way or the other.

Key data point to subdued consumption in Q1

Certainly, Japan's economy was subdued in Q1, with goods exports in retreat and domestic demand lacklustre. The BoJ's consumption activity indices and the Cabinet Office's synthetic consumption index – the best guide to the national accounts measure of private consumption – all suggested that growth in consumer spending was effectively absent. In particular, the synthetic consumption index fell 0.1%M/M in March to leave it down 0.2%3M/3M. And the BoJ's consumption activity index fell 0.7%M/M for the second successive month in March to leave growth in Q1 at zero, or 0.1%Q/Q when adjusted for net spending by foreigners. In the detail, real consumption of durable goods and services was relatively steady at 0.5%Q/Q and 0.2%Q/Q respectively. But spending on non-durable goods – long a source of weakness – was down 0.4%Q/Q.

Tertiary activity also flat

In terms of business activity, data released last month showed a sharp [drop in industrial production](#) in Q1 of 2.6%Q/Q. And figures released at the end of the past week showed that services, which account for almost three quarters of all industry activity, had an underwhelming quarter too. In particular, tertiary activity fell 0.4%M/M in March following a drop of 0.6%M/M the previous month, to leave growth in the sector over Q1 as a whole at zero. Among the various subsectors, contractions in retail and wholesale trade, utilities and ICT services in Q1 negated the boost from growth in finance, business services, hospitality, and medical, healthcare and welfare activity.

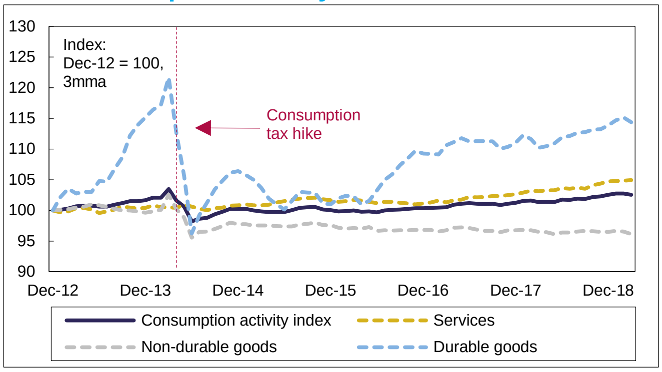
Economy watchers suggest little traction in Q2

Surveys suggest little improvement at the start of Q2. The [composite PMI](#) rose for the first time in six months in April but was still well below the average of the past two years. And the past week's Economy Watchers survey for the same month was little more encouraging. Having declined in March to its lowest level since July 2016, the headline current conditions index ticked up 0.5pt. But at 45.3, this was still the second-weakest reading in almost three years, and well below the key 50 'improving' level. Most components – including that for manufacturing – posted modest improvements. But all remained firmly in contractionary territory. And the forward-looking components pointed to an expectation of ongoing weakness, with the overall outlook index down for a third successive month to a four-month low of 48.4, closer to the bottom of the range of the past three years, led by a worsening of assessments of corporate sector demand, in particular in manufacturing, and employment conditions.

After soft Q1, a choppy profile for GDP ahead

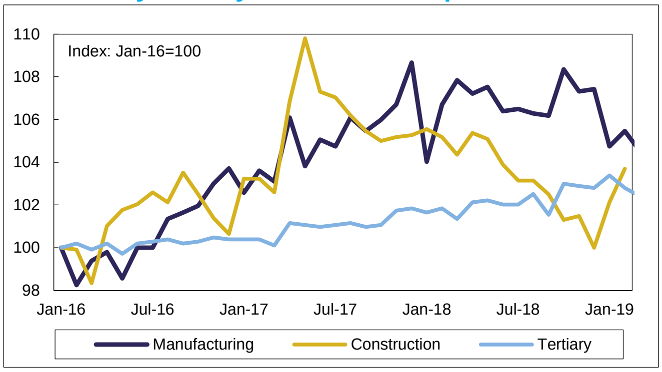
So, what does this all mean for economic growth? GDP was certainly subdued in Q1 with a possible drop in non- residential capex on top of a weak showing for private consumption. But housing investment likely rose for a third successive quarter, and net trade might well make a positive contribution thanks to

BoJ Consumption activity indices*



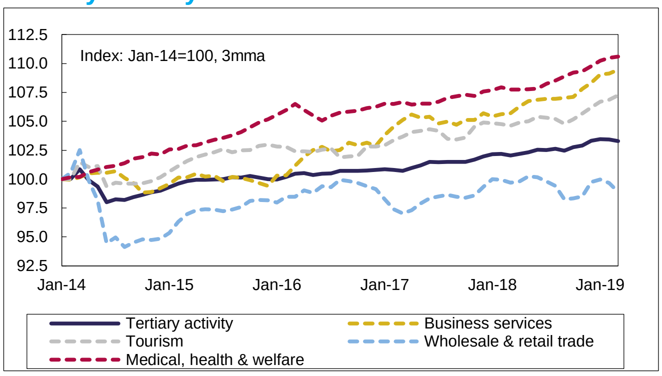
**Adjusted for net spending by foreigners.*
Source: METI and Daiwa Capital Markets Europe Ltd.

All industry activity index and components*



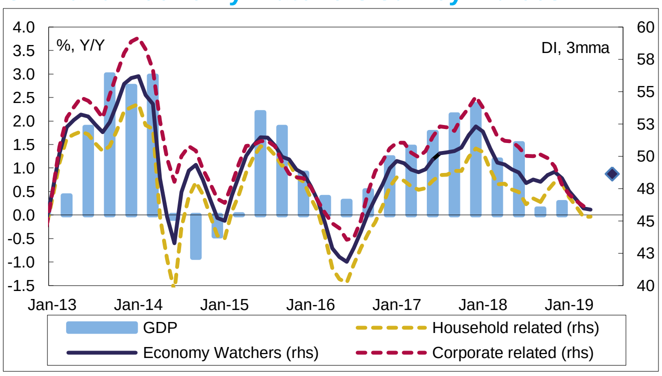
NB: Construction activity data for March 2019 not yet released.
Source: METI and Daiwa Capital Markets Europe Ltd.

Tertiary activity



Source: METI and Daiwa Capital Markets Europe Ltd.

GDP and Economy Watchers survey indices*



**Diamond represents three-month moving average of the headline Economy Watchers outlook index in April. Source: Cabinet Office and Daiwa Securities* a sharper drop in imports than exports. Overall, our colleagues in Tokyo forecast that GDP was little better than unchanged in Q1 with growth of just 0.1%Q/Q annualised. With some of the temporary factors that weighed on GDP in Q1 set to wear off, we expect positive growth in Q2 and an acceleration in Q3 as households bring forward purchases of big-ticket items ahead of the consumption tax hike. But that, of course, means we should expect payback with a marked drop in GDP in Q4.

Producer prices add little pressure to CPI

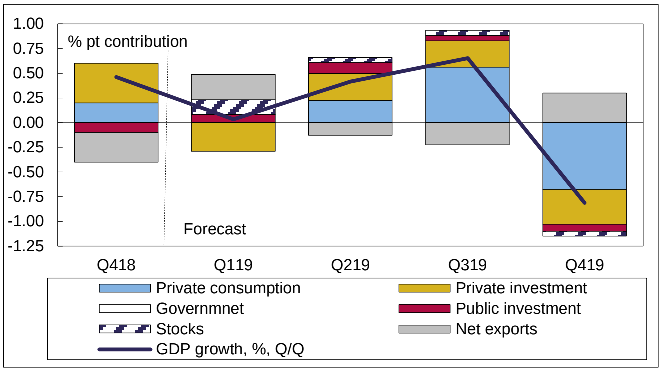
As a post script, the first inflation data for April – focussing on producer goods prices – suggested little pressure in the CPI pipeline. Admittedly, for a second successive month, the goods PPI rose a slightly larger-than-expected 0.3%M/M. But annual inflation eased 0.1ppt to 1.2%Y/Y, less than half the average rate last year. As in March, the largest price rise (and biggest contribution to the headline rate) came from petroleum and coal, up 3.3%M/M. And we expect prices of gasoline, and fresh food, to push up CPI inflation in April. Final producer prices for consumer goods rose 0.4%M/M pushing annual inflation on this measure back into positive territory for the first time in six months at 0.3%Y/Y. But prices of durable consumer goods were down 2.0%Y/Y (with prices of imported items down a hefty 4.4%Y/Y) while prices of nondurables were up 1.1%Y/Y. Overall, in yen terms imported consumer goods prices were down 0.8%Y/Y while prices of domestically produced items were up 0.7%Y/Y. And overall import price inflation subsided 0.7ppt from March to 1.8%Y/Y (down 0.7ppt from March).

The week ahead in Japan and the US

The coming week will kick off with the aforementioned Q1 preliminary national accounts. As above, we expect GDP to have been little better than unchanged from Q4. Final March IP data are also out on Monday. April goods trade and March machine orders data are due Wednesday. Exports are expected to remain down on the same month a year earlier, but import growth is expected to accelerate resulting in another monthly trade deficit. Private core machine orders are expected to be broadly flat on the month, leaving them down on a year-on-year basis. Thursday brings the May flash manufacturing PMI. Friday brings April national CPI data and the March all-industry activity index, which will include a read-out from the construction sector. Notably, the headline CPI rate is expected to rise 0.4ppt to 0.9%Y/Y partly due to increased inflation of fresh food. The BoJ forecast measure, excluding such items, is expected to rise 0.1ppt, also to 0.9%Y/Y. 'Core core' inflation, which also excludes energy prices, is expected to rise 0.2ppt to 0.6%Y/Y, which would be the highest since 2016. In the bond market, the MoF will auction 20Y JGBs on Wednesday.

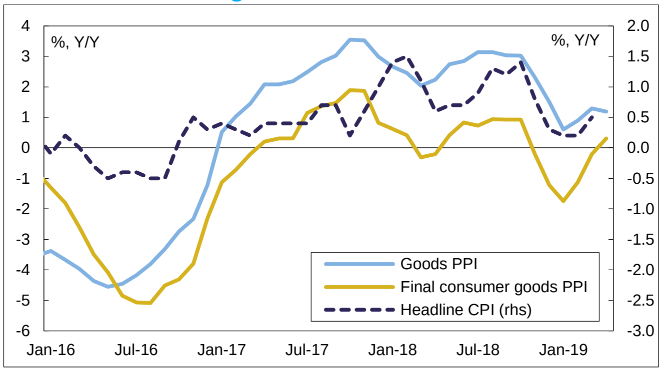
In the US, the coming week will be lighter than of late for economic data. Monday brings just the Chicago Fed National Activity indices for April, while the following day will bring April existing home sales data. The minutes from the May FOMC policy meeting are due on Wednesday. Along with the usual weekly claims figures, Thursday will bring new home sales data for April, and the preliminary Markit PMIs and Kansas City Fed manufacturing indices for May. And the preliminary durable goods orders figures for April are due on Friday. Meanwhile, Fed Chair Powell will speak at the Atlanta Fed Financial Markets Conference on Monday evening. In the bond market, the Treasury will sell 10Y TIPS on Thursday.

GDP Forecast



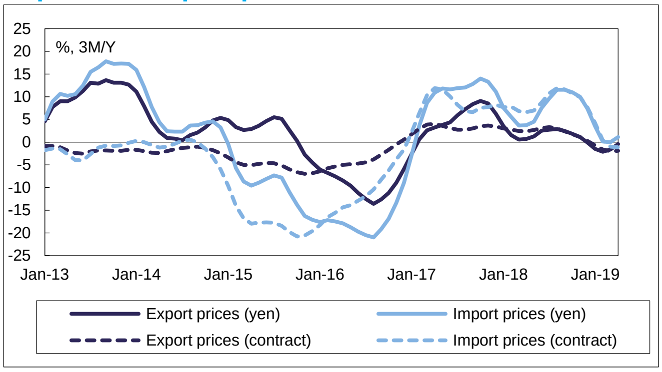
Source: Cabinet Office and Daiwa Capital Markets Europe Ltd.

Headline CPI and goods PPI



Source: BoJ, MIC and Daiwa Capital Markets Europe Ltd.

Export and import prices



Source: BoJ and Daiwa Capital Markets Europe Ltd.

Economic calendar

Key data releases – May/June

13	14	15	16	17
BOJ CONSUMPTION ACTIVITY INDEX M/M% FEB -0.3 MAR N/A COINCIDENT INDEX FEB 100.5 MAR P 99.6 LEADING INDEX FEB 97.1 MAR P 96.3	30Y JGB AUCTION ECONOMY WATCHERS SURVEY – CURRENT CONDITIONS DI MAR 44.8 APR 45.3 FUTURE CONDITIONS DI MAR 48.6 APR 48.4 BANK LENDING Y/Y% MAR 2.3 APR 2.4 CURRENT ACCOUNT ¥TRN FEB 2.0 MAR 1.3	M3 MONEY SUPPLY Y/Y% MAR 2.1 APR 2.2 MACHINE TOOL ORDERS Y/Y% MAR -28.5 APR P N/A CONSTRUCTION ORDERS Y/Y% MAR -3.4 APR 66.1	1Y TB AUCTION 5Y JGB AUCTION GOODS PPI Y/Y% MAR 1.3 APR 1.2	3M TB AUCTION TERTIARY ACTIVITY M/M% FEB -0.6 MAR -0.4
20	**21**	**22**	**23**	**24**
AUCTION FOR ENHANCED LIQUIDITY (APPROX ¥0.6TRN) GDP Q/Q% Q4 0.5 Q1 P 0.0 GDP DEFLATOR Y/Y% Q4 -0.3 Q1 P 0.2 INDUSTRIAL PRODUCTION M/M% FEB 0.7 MAR F -0.9 CAPACITY UTILISATION M/M% FEB 1.0 MAR N/A	HOUSING LOANS Y/Y% Q4 2.4 Q1 N/A DEPARTMENT STORE SALES Y/Y% MAR 0.1 APR N/A	20Y JGB AUCTION (APPROX ¥0.9TRN) TRADE BALANCE ¥BN MAR -178 APR -31 EXPORTS Y/Y% MAR -2.4 APR N/A IMPORTS Y/Y% MAR 1.2 APR 4.8 MACHINE ORDERS M/M% FEB 1.8 MAR 0.0 REUTERS TANKAN – MANUFACTURING DI APR 8 MAY N/A NON-MANUFACTURING DI APR 24 MAY N/A OVERSEAS VISITORS MN MAR 2.76 APR N/A	MANUFACTURING PMI APR 50.2 MAY P N/A	3M TB AUCTION (APPROX ¥4.28TRN) AUCTION FOR ENHANCED LIQUIDITY (APPROX ¥0.4TRN) NATIONAL CPI Y/Y% MAR 0.5 / APR 0.9 *EX FRESH FOOD* *0.8 / 0.9* *EX FRESH FOOD/ENERGY* *0.4 / 0.5* ALL INDUSTRY ACTIVITY M/M% FEB -0.2 MAR -0.1
27	**28**	**29**	**30**	**31**
	40Y JGB AUCTION SERVICES PPI (APR)		2Y JGB AUCTION	3M TB AUCTION INDUSTRIAL PRODUCTION (APR) RETAIL SALES (APR) UNEMPLOYMENT RATE (APR) JOB-TO-APPLICANT RATIO (APR) TOKYO CPI (MAY) HOUSING STARTS (APR) CONSTRUCTION ORDERS* (APR)
03	**04**	**05**	**06**	**07**
CAPITAL SPENDING SURVEY (Q1) MANUFACTURING PMI (MAY F) VEHICLE SALES (MAY)	10Y JGB AUCTION MONETARY BASE (MAY)	SERVICES PMI (MAY) COMPOSITE PMI (MAY)	6M TB AUCTION AUCTION FOR ENHANCED LIQUIDITY	3M TB AUCTION HOUSEHOLD SPENDING (APR) AVERAGE WAGES (APR) COINCIDENT INDEX (APR P) LEADING INDEX (APR P)

**Approximate date of release. Source: BoJ, MoF, Bloomberg, Thomson Reuters and Daiwa Capital Markets Europe Ltd.*

Economic Research

Key contacts

London		
Head of Research	*Chris Scicluna*	+44 20 7597 8326
Emerging Markets Economist	*Saori Sugeno*	+44 20 7597 8336
Economist	*Emily Nicol*	+44 20 7597 8331
Credit Analyst	*Israel da Costa*	+44 20 7597 8355
New York		
Chief Economist	*Mike Moran*	+1 212 612 6392
Junior Economist	*Lawrence Werther*	+1 212 612 6393
Hong Kong		
Economist	*Kevin Lai*	+852 2848 4926
Research Associate	*Eileen Lin*	+852 2773 8736
London Translation		
Head of Translation, Economic and Credit	*Mariko Humphris*	+44 20 7597 8327

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